

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of
SOUTHERN CALIFORNIA WATER
COMPANY (U 133-W), for an order
authorizing it to increase rates for water
service by \$19,826,100 or 29.72% in the year
2003; by \$6,327,800 or 7.31% in the year
2004; and by \$6,326,200 or 6.81% in the
year 2005 in its Region III Service Area and
increased rates for the General Office
Allocation in all of its Customer Service
Areas in this Application including: Arden-
Cordova, Bay Point, Clearlake, Los Osos,
Ojai, Santa Maria, Simi Valley and
Metropolitan

Application 02-11-007
(Filed November 4, 2002)

**COMMENTS OF THE OFFICE OF RATEPAYER ADVOCATES ON
THE DRAFT DECISION OF PRESIDENT PEEVEY AND
COMMISSIONER KENNEDY**

Decision 04-03-039 finds that Southern California Water Company (SCWC) violated Public Utilities Code section 851 for failure to obtain approval for a water rights lease agreement that it entered into with the City of Folsom (Folsom), and that, accordingly, the lease is void. The decision further orders SCWC to file, within 30 days, an application for prospective approval of the lease or a pleading indicating that it no longer wishes to lease water to Folsom.

On March 26, 2004, Folsom petitioned to modify D.04-03-039 to find that the lease is not void by virtue of Folsom being a “purchaser, lessee or encumbrancer dealing with such property in good faith for value.”

The March 26 Draft Decision of President Peevey and Commissioner Kennedy (DD) would grant the City’s petition and find that the lease is valid, and order SCWC to apply for section 851 approval for the limited purposes of determining the proper accounting treatment of future lease revenues and how

SCWC will obtain sufficient water to serve its customer base. The DD reaches this result by concluding as a matter of law that “the City is a good faith purchaser for value in compliance with §851” and that the Commission therefore has a duty to “reconcile the City’s needs for the leased water rights to its obligation to enforce §851 by determining whether or not the agreement between the City and SCWC for leased water serves the public interest.” (DD, Conclusions of law 3 and 4.)

In attempting to validate a void lease, the DD fundamentally misconstrues and legally misapplies section 851. Section 851 states plainly that any transaction disposing or encumbering property necessary or useful in the performance of utility service “[...] made other than in accordance with the order of the commission authorizing it is void.” Nothing in section 851 exempts the lease from being void for SCWC’s failure to first obtain the Commission’s authorization to enter into the lease.

Folsom, in its petition, raises the notion that section 851 exempts this transaction from being void by virtue of Folsom being as an “innocent purchaser,” “bona fide purchaser,” or a “purchaser, lessee or encumbrancer dealing with such property in good faith for value.” The DD’s effective endorsement of this argument is erroneous for being contrary to the plain language of the statute, the Commission’s prior pronouncement rejecting this very same argument, and common sense.

Section 851 states:

No public utility [...] shall sell, lease, assign, mortgage, or otherwise dispose of encumber the whole or any part of its [...] property *necessary or useful* in the performance of its duties to the public [...] without first having secured from the commission an order authorizing it so to do. Every such sale, lease, assignment, mortgage, disposition, encumbrance, merger, or consolidation made other than in accordance with the order of the commission authorizing it is void [...].

Nothing in this section shall prevent the sale, lease, encumbrance or other disposition by any public utility of property which is *not necessary or useful* in the

performance of its duties to the public, and any disposition of property by a public utility shall be conclusively presumed by be of property which is not useful or necessary in the performance of its duties to the public, as to any purchaser, lessee or encumbrancer dealing with such property in good faith for value [...]. (emphasis added)

By its plain language, the first paragraph of section 851 discusses property that is necessary or useful to the provision of utility service; the second paragraph refers only to the disposition of property that is *not* necessary or useful. Folsom does not challenge the Commission's legal conclusion in D.04-03-039 that the property in question was useful (conclusion of law 25), nor does the DD reverse that conclusion. As the Commission has found the property in question to be useful as a matter of law, the first paragraph of section 851 applies, and the lease, having been entered into without the Commission's prior authorization, is void.

Folsom disregards this distinction in the statute and argues that section 851's second paragraph provides that any transaction with a good faith purchaser, regardless of whether it involves useful property, and regardless of whether the utility obtained section 851 approval from the Commission, is categorically valid. (Petition, p. 8.) The Commission has previously considered and rejected this very same argument. In D.92-07-007, Pacific Gas and Electric Company (PG&E) likewise argued that, because the transaction was at arm's length with a "purchaser, lessee or encumbrancer dealing with such property in good faith for value," the property at issue must be "conclusively presumed to be of property which is not useful or necessary" in the provision of utility service and therefore did not require section 851 authorization. The Commission flatly rejected this interpretation of section 851:

This argument could, if accepted, be used to dispose of all the utility's assets with impunity. This result is, of course, nonsensical, and this interpretation of the statute completely contradicts § 851's primary determination that unauthorized dispositions of utility property are void. (Re PG&E (1992) 45 CPUC 24, 30.)

Interpreting the second paragraph of section 851 to presumptively validate any transaction of useful utility property involving a good faith purchaser would render section 851's primary determination meaningless. It would flatly permit the unbridled disposition of useful utility property without Commission review, simply by virtue of arm's length dealing. This result is nonsensical and untenable.

As the Commission states in D.92-07-007, "It makes much more sense to read this provision in § 851 to emphasize that the presumption is 'as to any purchaser, lessee or encumbrancer dealing with such property in good faith for value.'" (*Ibid.*) The presumption does not render valid an otherwise void transaction – that would render the entire statute meaningless. Rather, the presumption establishes that *a utility may not avoid liability to a bona fide purchaser* by virtue of having violated section 851. The presumptive conclusion is *as to the purchaser against the utility*; it is not as to any party against the Commission and its authority and statutory obligation to pre-approve dispositions of useful utility property. The presumptive conclusion may give Folsom a cause of action against SCWC, and SCWC may be liable to Folsom for lost value for the void lease. Nevertheless, as a matter of law, the lease is void.

D.04-03-039 judiciously recognizes the fact that the transaction between SCWC and Folsom from 1995 through the present is (please pardon) water over the dam, as well as the possibility that there may be a public interest in permitting a lease for the water rights going forward. Accordingly, although D.04-03-039 affects the relative rights of SCWC shareholders and ratepayers by making appropriate ratemaking adjustments, it explicitly leaves unaffected Folsom's rights and obligations to SCWC for the past period,¹ and orders SCWC to immediately "[...] either file an application for prospective approval of a lease of water rights

¹ D.04-03-039 appears to consider this result to be mandated by section 851's language regarding the conclusive presumption. (See, e.g., Ordering paragraph 7.) While ORA agrees with the result, we respectfully disagree that section 851 mandates it. Pursuant to section 851, the lease is void, past, present and future. However, the remedy for the past – the ratemaking adjustment and the penalty – has no practical effect on Folsom, and no practical action affecting Folsom's past rights and obligations is required.

to Folsom or file a pleading stating that it does not wish to lease water rights to Folsom and will not make such rights available to Folsom any longer.” (Ordering paragraphs 7 and 8.) The Alternative Draft Decision of Commissioner Lynch (also mailed March 26) (ADD) would further clarify that D.04-03-039 does not have any immediate effect on Folsom’s prospective rights and prohibit SCWC from interfering with Folsom’s use of the water under the terms of the lease pending further Commission action. (ADD, Ordering paragraph 1.)

The Commission must reject the DD. The Commission in D.04-03-039 duly finds the water rights at issue to be useful utility property; pursuant to section 851 the lease is therefore void and the Commission does not have the discretion to find otherwise. While the “conclusive presumption” language in the second paragraph of section 851 may confer rights upon Folsom, as a bona fide purchaser, as against SCWC, it does not render valid a void transaction. Decision 04-03-039, and as clarified in the ADD, does not adversely affect Folsom’s past rights and obligations, and protects Folsom going forward pending further Commission action concerning future treatment of the water rights at issue.

Respectfully submitted,

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March 30, 2004

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing document in
**COMMENTS OF THE OFFICE OF RATEPAYER ADVOCATES ON THE
DRAFT DECISION OF PRESIDENT PEEVEY AND COMMISSIONER
KENNEDY** in A.02-11-007.

A copy was served as follows:

☒ **BY E-MAIL:** I sent a true copy via e-mail to all known parties of record who have provided e-mail addresses.

☐ **BY MAIL:** I sent a true copy via first-class mail to all known parties of record.

Executed in San Francisco, California, on the **30th** day of **March, 2004**.

/s/ Albert Hill

Albert Hill